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To: Supervisor Gloria Molina, Chair  
Supervisor Yvonne Brathwaite Burke  
Supervisor Zev Yaroslavsky  
Supervisor Don Knabe  
Supervisor Michael D. Antonovich

From: J. Tyler McCauley  
Auditor-Controller

Subject: **FISCAL AUDIT OF INNER CIRCLE FOSTER CARE AND ADOPTION SERVICES - A FOSTER FAMILY AGENCY CONTRACTOR**

Attached is our audit report on Inner Circle's (Inner Circle) fiscal operations for the period January 1, 1999 through December 31, 1999. For certain items, because of issues noted, we expanded our review period. Inner Circle is licensed to operate a Foster Family Agency (FFA) and, for the period of our review, had 49 certified homes with 78 children placed in those homes. Inner Circle's administrative offices are located in the Third Supervisorial District.

The Department of Children and Family Services (DCFS) contracts with Inner Circle to provide the basic needs and services for foster care children placed in the Agency's care. Under the provisions of the contract, DCFS pays Inner Circle a monthly rate per child, based on rate criteria established by the California Department of Social Services (CDSS). Inner Circle receives a monthly rate between \$1,394 and \$1,644 per child and pays the foster parents between \$618 and \$721 per month (CDSS requires the FFA to pay a minimum of \$565 and \$715 per child). During the period of our review, Inner Circle received approximately \$1,337,590 from DCFS and paid out approximately \$593,302 to foster parents.

**Scope**

The purpose of our review was to ensure that Inner Circle has complied with the contract and appropriately accounted for and spent foster care funds on allowable and reasonable expenditures in providing services to children placed in the Agency's care. We also evaluated the adequacy of Inner Circle's accounting records, internal controls and compliance with applicable federal, State and County fiscal guidelines governing the disbursement of FFA foster care funds.

### **Summary of Findings**

Our review disclosed a total of \$243,803 in questioned costs. Of this amount, \$224,569 represents compensation paid to, or on behalf of, the former Executive Director (Director) for the period February 12, 1995 through December 31, 1999. We questioned the former Director's annual salary because it appeared excessive when compared to the salaries of other executive directors. We also questioned \$46,243 in expenses related to the former Director's personal vehicle and \$50,000 in personal retirement plan contributions. We noted that the last \$20,000 in retirement plan payments appear to have been split by the former Director, which circumvented the Agency's disbursement controls. In addition to the former Director's compensation, we found \$19,234 in other questioned costs, including unsupported payroll, credit card and vehicle-related expenses. We have recommended that DCFS resolve the questioned costs and, if appropriate, collect any disallowed amounts.

We also noted areas where Inner Circle needs to correct contract compliance deficiencies and internal control weaknesses over their expense allocation, disbursement, payroll and bank reconciliation procedures.

### **Review of Report**

We discussed our report with Inner Circle management on October 2, 2000. They have agreed to provide DCFS with a written response and corrective action plan within 30 days of the report date. In addition, DCFS has agreed to provide my office with a written response within 60 days detailing the resolution of all findings contained in the report. We thank Inner Circle management and staff for their cooperation during our review.

JTM:PTM:MR:RD

### **Attachment**

c: David E. Janssen, Chief Administrative Officer  
Public Information Office  
Audit Committee Members  
Commission for Children and Families  
Department of Children and Family Services  
Anita Bock, Director  
Barry Chass, Executive Consultant  
Ed Sosa, Chief, Out of Home Care Programs  
Genevra Gilden, Chief, Quality Assurance Division  
Inner Circle – Foster Family Agency  
Mary Bruggeman Daniel, Executive Director  
Board of Directors  
California Department of Social Services  
Sharon Ferrante, Chief, Foster Care Audits Bureau  
Judy Colbert, Chief, Foster Care Audits Branch

**Inner Circle Foster Family Agency**  
**Fiscal Audit of Foster Family Agency Contract**

**Schedule of Findings**

**Background**

The Department of Children and Family Services (DCFS) contracts with Inner Circle Treatment Centers (Inner Circle) to provide the basic needs and services for foster care children placed in the Agency's care. Inner Circle is licensed to operate a Foster Family Agency (FFA) and, as of our review, had 49 certified homes with 78 children placed in those homes. Inner Circle's administrative office is located in the Third Supervisorial District.

Under the provisions of the contract, the County pays Inner Circle a monthly rate for each child, based on rate classification levels determined by the California Department of Social Services (CDSS). Inner Circle receives a monthly rate between \$1,394 and \$1,644 per child, based on the child's age. During the period of our review, January 1, 1999 through December 31, 1999, Inner Circle received approximately \$1,337,590 in foster care funds from DCFS.

The CDSS has also established minimum amounts the FFA is required to pay certified foster parents. Beginning July 1, 1999, the FFA is required to pay a minimum monthly rate of \$565 to \$715 per child, based on age of placement. Inner Circle pays its certified foster parents between \$618 and \$721 per month and, during the period of our review, paid out approximately \$593,302.

**Applicable Regulations and Guidelines**

Inner Circle is required to operate its FFA in accordance with certain federal, State and County regulations and guidelines. We referred to the following applicable regulations and guidelines during our audit:

- FFA Contract, including Exhibit F, Auditor-Controller Contract Accounting and Administration Handbook (A-C Handbook) and Exhibit D, DCFS' Contract Accounting and Operation Handbook (DCFS Handbook).
- Federal Office of Management and Budget Circular A-122 (Circular), Cost Principles for Non-Profit Organizations.
- California Department of Social Services Manual of Policies and Procedures (CDSS-MPP).
- California Code of Regulations, Title 22 (Title 22).

### **Summary of Findings**

Our review disclosed a total of \$243,803 in questioned costs. Of this amount, \$224,569 represents compensation paid to, or on behalf of, the former Executive Director (Director) for the period February 12, 1995 through December 31, 1999. We expanded our review period for certain items related to employees' compensation. It should be noted that the former Executive Director referred to in this report retired on December 15, 1999. In addition to the former Director's compensation, we found \$19,234 in other questioned costs, including unsupported payroll, credit card and vehicle-related expenses. We also noted areas where Inner Circle needs to correct contract compliance deficiencies and strengthen internal controls.

### **Questioned Costs**

The questioned cost section is divided into two parts: "Questioned Compensation Paid to the Former Executive Director" and "Other Questioned Costs".

#### **Questioned Compensation Paid to the Former Executive Director**

We questioned \$224,569 in compensation paid to the former Director for the period February 12, 1995 through December 31, 1999. Except for \$34,326 in unsupported salary payments, the former Director's compensation was approved by Inner Circle's Board of Directors and documented in the employment agreement. However, the compensation appears excessive when compared to the compensation of other agency directors. For the one-year period, January 1, 1999 through December 31, 1999, the former Director received \$143,104 in compensation, including pension payments, insurance premium payments and vehicle-related expenses paid on her behalf.

#### **Unsupported Compensation**

We are questioning \$34,326 in unsupported base salary payments to the former Director. The former Director received base salary income of \$296,326 for calendar years 1997 through 1999. However, based on the employment agreements approved by Inner Circle's Board of Directors, she was entitled to \$262,000 during that period.

#### **Excessive Compensation**

We questioned \$144,000 paid to the former Director as follows:

- \$105,427 (\$11,427 of this amount is unsupported and included in the Unsupported Compensation section above) in base salary income for the period January 1, 1999 through December 31, 1999. We noted that Inner Circle's succeeding Executive Director is currently paid \$70,000 annually. Currently, there are no CDSS or DCFS guidelines, specific to FFAs, that establish annual salary limits for executive directors. However, we did note the following:

- A 1999 salary study performed by the Child Welfare League of America found an average executive director salary of \$68,012 for agencies with revenues ranging from \$1-2 million. Inner Circle had 1999 revenue of \$1.4 million.
  - A 1998 salary survey of 42 FFAs found an average executive director salary of \$70,671 for agencies with revenues ranging from \$1-2.99 million.
  - Six FFA audits conducted since January 1, 1999 by the Los Angeles County Auditor-Controller's office revealed that the average annual salary for FFA executive directors is approximately \$75,000.
- \$50,000 in payments during the period March 4, 1998 through December 14, 1999 to establish a deferred compensation account for the former Director. We noted that the Agency did not have a contributory retirement plan in place for any other Agency employees and that the current Director does not receive such compensation. In total, \$50,000 of Agency funds have been deposited to this account, which had an accrued net value of \$65,622 as of April 30, 2000. We noted that the last \$20,000 in contribution payments appear to have been split by the former Director, which circumvented the Agency's disbursement controls. Per the Agency's internal control policy, checks for more than \$5,000 must carry two signatures. On two separate occasions, the Director prepared and signed two sequentially numbered checks for \$5,000 each, on the same day.

### **Unallowable Compensation**

Our review disclosed that the Agency paid the former Director \$46,243 in unallowable compensation, including expenses for car payments, vehicle registration payments, vehicle insurance, vehicle repairs and gasoline purchases.

The Circular, Section 7.g., states that the cost of organization-furnished automobiles that relate to personal use by employees (including transportation to and from work) is unallowable as a fringe benefit or indirect cost, regardless of whether the cost is reported as taxable income to the employees. Dating back to 1995, the Agency has paid for most expenses associated with an automobile that was owned and driven exclusively by the former Director. This vehicle was registered in the former Director's name and was used for both business and personal transportation, including driving to and from work.

Since the Agency made no distinction between business and personal use, all expenses paid by the Agency for this vehicle are deemed unallowable. We found the following unallowable vehicle-related expenses paid on behalf of the Director dating back to February 12, 1995:

- \$33,335 in vehicle loan payments.

- \$2,266 for vehicle registration fees.
- \$5,014 for vehicle insurance premium payments.
- \$5,628 for gasoline and vehicle repairs paid by the Director with the Agency's American Express card dating back to 1995. The Director did not maintain travel/mileage logs for the vehicle and could not substantiate that the vehicle was used for business purposes to benefit the FFA.

### **Other Questioned Costs**

In addition to the questioned compensation paid to the Executive Director, our review disclosed a total of \$19,234 in other questioned costs, as follows:

### **Unsupported Costs**

We found a total of \$8,149 in unsupported costs as follows:

- \$7,205 in unsupported payroll costs for one Agency employee. The Agency did not have documentation to support the employee's increased salary rate for the period September 1, 1997 through September 15, 1999. As a result, we questioned amounts paid in excess of the most current approved salary rate for that period.
- \$744 in questionable expenditures not supported with vendor receipts. Specifically, we noted various company credit card charges to pay for business meals, tuition, books and publications and plane fare to educational conferences that were not supported by receipts.
- \$200 to an independent contractor. The Agency could not provide us with a contract or valid invoice to support this payment.

### **Unallowable Costs**

The Circular requires that funds be used only for those expenditures that are reasonable and necessary to carry out the purposes and activities of the FFA program. Inner Circle incurred \$11,085 in expenditures that were unrelated to providing the necessary care and services to children placed by Inner Circle. Specifically we noted:

- \$6,900 in car payments for the Assistant Executive Director's personal automobile. The car was driven exclusively by the Assistant Executive Director and no distinction was made between its personal and business use. These expenses are similar in nature to the Director's unallowable vehicle expenses (see Unallowable Compensation above).

- \$918 in gas charges paid by the Assistant Executive Director. The Assistant Director did not maintain travel/mileage logs for her personal vehicle and could not substantiate that the vehicle was used for business purposes to benefit the FFA.
- \$360 in American Express charges, including an engraved bracelet for the retiring Executive Director.
- \$2,130 for a computer the former Director took with her when she retired.
- \$777 in other unallowable expenses, including a custom designed necklace and an engraved plaque for the former Executive Director.

### **Recommendations**

#### **DCFS management:**

1. **Resolve the \$243,803 in questioned costs and, if appropriate, collect any disallowed amounts.**
2. **Work with the State to establish compensation guidelines for FFA Executive Directors. Include the guidelines in the FFA Contract or as a separate addendum to the Contract.**

#### **Inner Circle management:**

3. **Ensure foster care funds are spent on allowable and reasonable costs to benefit the foster children, in accordance with the Contract and applicable federal, State and County regulations and guidelines.**
4. **Maintain adequate supporting documentation for all foster care expenditures, including original itemized receipts, invoices, contracts and detailed travel/mileage logs.**

### **Unresolved Payment Discrepancies**

Our review of the Agency's accounting records disclosed that as of May 8, 2000, the Agency owed the County \$1,362 for one overpayment dating back to September 1999. The Agency did not file a payment resolution form (COV 71) regarding this overpayment until May 8, 2000. We also noted that DCFS owed the Agency \$105 for one underpayment dating back to December 1999. The Agency had submitted a payment resolution form for this underpayment but received no response from DCFS.

DCFS needs to ensure all payment discrepancies are identified and resolved in a timely manner. In addition, the Agency should submit COV 71 forms to DCFS for all payment discrepancies to ensure prompt resolution.

### **Recommendations**

#### **DCFS management:**

- 5. Work with Inner Circle management to resolve all outstanding foster care payment discrepancies.**
- 6. Monitor payments to foster care agencies more closely to ensure correct amounts are paid and any over/underpayments are resolved immediately.**

#### **Inner Circle management:**

- 7. Ensure all foster care payment discrepancies, including overpayments, are reported to DCFS within 30 days.**

### **Contract Compliance and Internal Controls**

Our review disclosed the following contract compliance issues and internal control weaknesses that require corrective action by Inner Circle.

### **Allocation of Expenses**

According to the Circular, costs incurred for the benefit of more than one program should be allocated such that each program receives a reasonable share of costs. Those costs in which the relative benefit to each program can be readily identified may be directly allocated using measurable, quantified units (time records of actual hours worked by program, square footage, number of employees, units of service, etc.). All other costs should be accumulated as indirect costs and allocated using total direct costs, direct salaries and wages, or other bases that will result in an equitable distribution of costs to the benefiting programs.

The Agency did not allocate direct expenses in accordance with the Circular and A-C Handbook. The Agency became licensed to operate an adoption program on May 3, 1999 and a developmentally disabled program on September 26, 1997. While the Agency did allocate direct expenses to the developmentally disabled program, it did not allocate for the adoption program. Instead, these expenses were charged to the Foster Family Agency program during the period of our review.

The Agency also did not allocate indirect costs appropriately. Salaries for the Director, Assistant Director, Office Manager and receptionist and rent and utilities for the administrative building were charged entirely to the FFA program instead of to all three programs.

Inner Circle management needs to develop and implement a cost allocation plan that incorporates the cost principles specified in the Circular and A-C Handbook. In addition, the Agency needs to apply the plan retroactively so that the shared expenses described above are charged appropriately to each program. The cost allocation plan should be reviewed and approved by DCFS management.

### **Recommendation**

#### **Inner Circle management:**

- 8. Develop and implement a cost allocation in accordance with the cost principles specified in the Circular and the A-C Handbook.**
- 9. Apply the cost allocation plan retroactively.**

#### **DCFS management:**

- 10. Review and approve the Agency's cost allocation plan and ensure it is applied retroactively.**

### **Disbursement Procedures**

We noted the following disbursement weaknesses:

- Section 4.012 of the A-C Handbook states that a second signature shall be required on all checks. Inner Circle policy requires a second signature only for disbursements above \$5,000. We also noted that one cancelled check had not been signed at all. Ideally, Agency management should require two signatures on all checks to ensure disbursements are appropriate and authorized and that an adequate system of checks and balances exist. At minimum, the Agency should work with DCFS to establish a more appropriate minimum limit for checks that require a second signature.
- Adequate supporting documentation is not maintained for credit card purchases. The Agency maintains credit card statements, but does not always maintain vendor receipts. According to the A-C and DCFS Handbooks, all credit card disbursements must be supported by original invoices or receipts indicating the item purchased and the purchaser.

Without proper disbursement controls in place, Inner Circle cannot ensure Foster Family Agency funds are spent on reasonable and allowable expenditures for providing the necessary care and services to the children placed in the Agency's care.

### **Recommendations**

#### **Inner Circle management:**

- 11. Require two signatures on all Agency disbursements, or work with DCFS management to establish an appropriate limit for requiring a second signature.**
- 12. Maintain original, itemized vendor receipts for all credit card purchases.**

### **Compliance with Federal and State Payroll Tax Regulations**

Since 1998, the Director has received \$3,920 in disability insurance premiums. However, the Agency did not withhold taxes from the Director's salary for the premiums. Per the Circular, costs of insurance on the lives of officers are only allowable to the extent that the insurance represents additional compensation. Therefore, the Agency must report these premiums as additional compensation and remit any taxes to the appropriate taxing agencies.

### **Recommendation**

#### **Inner Circle management:**

- 13. File correct W-2 Forms that encompass all salaries and wages paid to the Agency's Director, and ensure that all salaries and wages paid are reported to the appropriate taxing agencies.**
- 14. Ensure that all salaries and wages are processed through payroll and that all appropriate payroll taxes are withheld.**

### **Bank Deposits**

Our review disclosed that the Agency does not have a formal policy dictating the frequency of bank deposits. Per management, deposits are usually made weekly or when \$1,000 in collections is accumulated. To ensure adequate security over foster family funds, the Agency should make deposits daily or when collection amounts reach \$500, in accordance with the DCFS Handbook. In no case should deposits be less frequent than weekly.

**Recommendation**

- 15. Inner Circle management ensure bank deposits are made daily or when collection amounts reach \$500.**

**Bank Reconciliations**

Our review of Inner Circle's banking records disclosed several control weaknesses that require corrective action by Inner Circle's management. Specifically, we noted that the Agency maintains records of their monthly bank reconciliations on computer only. Since hard copies are not printed and maintained, bank reconciliations are not signed and dated by the preparer. Also, supervisory personnel do not review and approve bank reconciliations and reconciling items are not resolved in a timely manner. We noted two outstanding checks totaling \$1,744 that were nine months old, dating back to August 1999.

The A-C Handbook requires bank accounts be reconciled monthly, ideally within 30 days of the bank statement date. Further, bank reconciliations should be reviewed for appropriateness and accuracy, and approved in writing by management.

**Recommendations****Inner Circle management:**

- 16. Ensure that monthly bank reconciliations are printed. The reconciliations should be signed and dated by the preparer and approved in writing by management.**
- 17. Ensure all outstanding checks are followed-up on and resolved in a timely manner.**

**Independent Contractors**

We noted that independent contractors were operating without written agreements specifying the nature of services to be provided and the rate to be paid for those services. Since the Agency had invoices to support the services, we did not question the amounts paid. However, the Agency must maintain written agreements with each independent contractor in accordance with the Circular and the A-C Handbook.

**Recommendation**

- 18. Inner Circle management establish written agreements with all independent contractors that contain a description of the service, estimate of time required, rate of compensation and termination provisions.**

**Foster Parent Agreements**

Our review disclosed that the Agency does not maintain current financial agreements with foster parents. The amount of compensation a foster parent receives will vary depending on the child's age, Agency policy and rate changes issued by the State. Inner Circle does not update foster parent contracts after the children's initial placement with a family. We noted one instance where payment rates had increased three times but were not reflected in the foster parent's file. To avoid potential disputes regarding payment, the Agency should maintain a current, signed agreement that specifies the payment rate for each child placed with a foster family.

**Recommendation**

- 19. Inner Circle management ensure that, for each foster child placed in a foster home, the Agency maintains an agreement clearly specifying current payment terms.**

**Payroll Procedures**

During our review of Inner Circle's controls over payroll, we noted the following:

- Ten of ten employee timecards reviewed were not signed by Agency management to document their review and approval of actual hours worked. Inner Circle's management should sign employee timecards to certify the accuracy of reported hours worked.
- As indicated in the Questioned Cost section, two employees' personnel files did not contain current approved salary rates. Without documentation of approved rates we cannot determine whether salaries paid are authorized and appropriate. Current payment rate information should be maintained in all employee personnel files so that it may be readily available upon audit.

**Recommendations**

**Inner Circle management:**

- 20. Ensure employee timecards are reviewed and approved in writing by management.**
- 21. Ensure personnel files contain authorized salary amounts or hourly rates of pay approved by management.**

**Insurance**

Inner Circle is required to maintain insurance coverage that includes a provision that the County will be notified by the insurance carrier 30 days in advance of policy termination or modification. We noted the Agency's workers' compensation policy provides for a 10-day advance notice.

**Recommendation:**

- 22. DCFS management ensure Inner Circle's insurance policy contains a provision that the County will be given a minimum of 30 days written notice in the event of policy cancellation.**